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PRIME MINISTER

DEPUTY PRIME MINISTER

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INDUSTRY POLICY

I know you have been giving some thought to the subject of industry policy, as I have, and I want to share my views with you. Michael Heseltine has been particularly helpful in encouraging creative thinking.

The term "industry policy" has acquired a bad reputation in the UK as a result of misguided and clumsy interventionism in the 1970s: "picking winners" (often, losers); state subsidies; "economic planning". There were however more successful, albeit different, experiences in France, Germany, Korea, Japan and Singapore. One of the messages I hear from business – this last week in a long conversation with Ratan Tata and Cyrus Mistry – is that we have swung too far in the opposite direction.

We have united the Government around an economic strategy which attracts widespread support: restoring fiscal credibility which enables loose monetary policy; an export drive centred on emerging markets; a warm welcome for inward investors; an ambitious infrastructure plan; a strong commitment to business-relevant skills and apprenticeships; universities put on a sound financial footing for teaching, research and business engagement; and a better process for stemming and cutting red tape. Our Growth Review has identified numerous action points and policy changes – as with the planning system – which could speed up growth in the medium to long term. In all of these areas, we are agreed on the way forward; the priority now is implementation.

I sense however that there is still something important missing: a compelling vision of where the country is heading beyond sorting out the fiscal mess; and a clear and confident messege about how we will earn our living in future. After the best part of a decade in Shell I know enough about the difficulties of long term planning not to be seduced into believing that we can predict the economic cycles and market driven competitive forces of the future. But that experience did teach me the importance of thinking a decade or two ahead, beyond the electoral angle, which our top industrialists are clamouring for. We can be more strategic, and the economic backdrop will increase demands that we are ambitious.

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Recent bad news from Bombardier, BAES and Rio Tinto Alcan will not be the last, with potentially difficult announcements from General Motors and the knock-on from the possible loss of the Typhoon contract. None of these can be blamed on the Coalition, but the policies we inherited have played a role: notably, our procurement rules in the case of Bombardier, but also our planning rules in the case of Pinewood Studios being denied planning permission. Together they point to a lack of strategic pro-growth thinking in previous administrations, which we must now address.

Market forces are insufficient for creating the long term industrial capacities we need. Despite the biggest devaluation since the War, improvement in the UK's trade balance has been disappointing. The Labour boom and bust hollowed out the supply chains on which exporters and inward investors depend. And while controversy rages over bankers' bonuses, the much bigger problem is the lack of confidence businesses have in their ability to find affordable financing for future investment. All in all, we must lay out a strategic vision for where our future industrial capabilities should lie, and how to deliver it.

So much for analysis and criticism (including self criticism). What is to be done? I have five suggestions.

First the Government can show more leadership in identifying and supporting key technologies. We have a fantastic scientific tradition in this country, and technology leadership must drive economic activity in the future. This government has done some good things – protecting science spending; launching the first wave of "Catapult" centres, supporting the growth of Tech City and shifting resources towards STEM subjects and Apprenticeships. But our actions are, frankly, rather piecemeal. There are lots of individual funding decisions that lack support in other policy areas, or are not followed through systematically. The Technology Strategy Board, which works with business to deliver priorities, is operating on a shrinking core budget and thereby missing valuable opportunities. There are gaps in the UK innovation system, notably a lack of support for large scale demonstration of new technologies.

All of this calls for a stronger steer from government to build certainty and hence the confidence to invest. So a better resourced operation is needed, explicitly bringing together the Government's technology priorities, and making the right links with other levers across government.

Second, and more controversially, we should be willing to identify British success stories, as identified through success in trade, and explicitly get behind them at the highest political level. Without in any way picking winners, it is possible to identify some loosely defined sectors which merit close attention and backing:

- "advanced" manufacturing and related services For example, the aerospace and automotive sectors are each an important UK success story. Beneath these industries are broad supply chains and key relationships with other growth areas like composites and plastic electronics. But overcapacity in the European car industry, and the potential retreat of BAE and EADS from UK

production, are putting this at risk. We have structures in place to discuss these challenges – the Automotive Council and the Aerospace Leaders Group – but must soon decide how much support we can give. I do not support us propping up clearly failing enterprises. But when commercial decisions of international companies might cause the decline of a wide industry, we need to plan how to develop a proper strategic partnership that retains capabilities in this country.

- Digital/creative industries: In this area of huge potential there are a lot of quiet success stories, largely without direct government help; the UK leads the world in e-commerce for example. We have taken important early steps, including the rollout of superfast broadband and copyright reform. But the Creative Industries Council which Jeremy and I have esteblished is identifying serious problems which make global champions like ARM the exception rather than the rule. Despite fantastic SMEs, we have produced no Amazon, no Google and no Intel. Key issues are in finance and skills, including how our equity markets function that leave too few potential giants to expand organically rather than sell up.

- Traded services are crucial to rebalancing the economy towards exports. These include professional and business services such as architects, consultants, accountants and lawyers; tourism; higher and further education; large parts of the financials sector which were largely blameless in the crisis. As the global economy expands these will become ever more important. But the government does not yet have a clear strategy for how to address the pressing issues, such as how to design our immigration cap for rapid global growth, or improve future language skills.

- Energy industries and low carbon: in recent years the oil and gas exploration industry feels it has been taken for granted, despite generating vast investment and supporting impressive supply chains with unexploited potential (shale gas). We need to remain sensitive to the Scottish dimension, with the perception that Alex Salmond cares and London doesn't. While we are making moves to promote the next generation of renewables (nuclear and offshore wind), there is as yet little attention given to supply chain issues. We also need to make stronger links between policies to reduce energy use - like the Green Deal and smart meters - and jobs and growth. And the UK has the potential to create a leadership position in a number of important areas of the low-carbon transport revolution.

This list of sectors is not, of course, exhaustive. It is meant to illustrate areas where we need a more strategic and proactive approach using all of the government's policy levers – rather than simply responding to crises efter they have developed, or waiting to see what the market dictates. Further analysis of future trends – such as the demographic transition, and the need for future infrastructure – ought to yield other significant areas that demand a similar strategic approach.

Third, a connecting thread is the need for strategic and long term thinking about supply chains and the role played in them by public procurement decisions. This should extend to all areas where the government exercises significant influence, such as in energy or other regulated sectors. There is some positive thinking about the NHS and Life Sciences but no connected approach across Government. Ratan Tata and Vincent de Rivaz, among many others, express great frustration about lack of joined up thinking in this area. We must now achieve thorough implementation of the decisions that we took before the Autumn Statement to move policy in a new direction. This will be very challenging. It will require sustained engagement by Ministers, careful management of specific cases coming forward and ultimately nothing less than a change in mindset and capability across the public sector. I recognise the difficult of balancing strategic procurement and cost cutting, not least in defence, and welcome the leadership Number 10 has shown here. Where we know big investment decisions are going to be made (such as in rail, nuclear, offshore energy etc), we need to put in place a strategy actively to plan how we will strengthen the supply chain, develop the skills needed in this country, and provide certainty to business.

Fourth, the banking crisis casts a long shadow. Not only does there remain considerable pro-cyclical behaviour, but we also inherited from Labour a banking industry structurally ill placed to serve the needs of productive businesses. We badly need an initiative that gives business confidence that expansion will not be choked off by the banks. My suggestion is that we recognise that RBS will not return to the market in its current shape and use its time as ward of state to carve out of it a British Business Bank with a clean balance sheet and a mandate to expand lending rapidly to sound business.. We should be willing to use such an institution to support our other industrial objectives, such as supporting exports and sectors identified as of strategic importance. But this will take time and in the meantime we have to get the state banks lending to business, especially SMEs.

We must also consider creative non-bank channels: the Taskforce led by Tim Breedon that I have established is examining every opportunity to build more sustainable markets for business finance in the future. That will report in the next few weeks. In the immediate term, we should be examining how the funds allocated to credit easing could channel credit through entities that have trusted relationships with businesses, or service providers to the business community. We should be bold: in the private sector, it is normal to pilot schemes and not be afraid to risk failure: we need to adopt a similar approach in how we launch innovative policy experiments to find effective alternatives to banking as a source of credit. These are not terribly expensive but could turn out to be instrumental both in supporting the recovery and in rebalancing the economy.

Finally, the economy will continue to struggle while the construction industry remains so depressed. By contrast the big recovery in the 1930s was driven by a combination of new industries (cars and chemicals) and construction: estates of semis and lots of council housing. Construction provides plenty of jobs and supports UK supply chains, including innovative products, ranging from new more sustainable

construction materials to energy saving technologies. I strongly welcome the Housing Strategy that Number 10 developed last autumn. Galvanising the housing construction market would have a much wider economic impact in stimulating innovation and growth, and I absolutely agree that it should be an important priority. There is a particular problem with financing; the housing associations, which could drive recovery, are unable to mobilise funds on any scale. We should have the same level of commitment across Government to getting housing moving as is beginning to happen for infrastructure.

These are some brief thoughts on big and complex issues. I welcome that Number 10 has been exploring other options, and am keen that we work together on this. I would welcome an opportunity to discuss with you and colleagues how to make headway on industrial policy and what the next steps should be.

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